C·P·S· POLICY CHALLENGE

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SIGNALS FROM A RAILWAY CONFERENCE

JOHN REDWOOD MP

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CENTRE FOR POLICY STUDIES

8 Wilfred Street, London SW1E 6PL

1988

The author

John Redwood has been an active member of the Centre for Policy Studies' Nationalised Industry Group for more than a decade and a frequent writer on privatisation. Now Member of Parliament for Wokingham, his previous careers included being Executive Director and Head of a leading merchant bank's Overseas Privatisation Team, and Head of the Prime Minister's Policy Unit at Downing Street.

His publications include Popular Capitalism (1988), Public Enterprise in Crisis (1980) and several CPS pamphlets.

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Programme outline

REVIVING THE RAILWAYS

at The Queen Elizabeth Conference Centre, Broad Sanctuary SW1
on Friday 28 October 1988

Simon Webley, a Director of the CPS, in the chair

9 am - 9.30	Coffee will be served
9.30 - 10.00	1. Opening speech from the Secretary of State for Transport, The Rt Hon Paul Channon MP
	CONTRIBUTIONS OF 5 - 10 MINUTES EACH
	2. Richard Hannah, Transport Analyst, Phillips and Drew
	3. David Starkie, T M Economics and the Institute of Fiscal Studies
	4. Andrew Gritten, author of 'Reviving the Railways'
	5. John Redwood, MP
	6. Dr Tony Ridley, Chairman and Managing Director, London Underground
10.50 - 11.00	Coffee
11.10 - 12.30	Questions from the floor

Introduction

ON FRIDAY 28 OCTOBER THE CENTRE FOR POLICY STUDIES ASSEMBLED SOME one hundred railway enthusiasts, analysts, critics and transport specialists for a conference to discuss ways forward for British railways. The programme for the conference, which was addressed by the Secretary of State for Transport, is shown opposite; and the list of those attending is given in the Appendix, together with the Secretary of State's speech.

It was common ground that the railways now have a unique pportunity. They have experienced a period of some 30 years of rogressive decline, where it has been accepted that the railway isease is progressive if not terminal. But now, with the openng of the Channel Tunnel and the operation of the Single Euroean market both imminent, their future is, or should be, brightr than at any time during this century.

Yet the stance of British Rail is still essentially defenive. Many at the Conference felt that large market opportunities d been, and still were being, missed. There have been endless bates about the correct level of subsidy with the assumption at if the subsidy is reduced the volume of traffic and the mber of services would also have to be reduced. The thrust of e investment programme has been to modernise, replace and prove existing traction systems and rolling stock. There has en practically no new investment in expanding or changing the pe of the network.

Since the war British Rail has had the opportunity to turn a ies of regional railways inherited from the private sector o a truly national network. They have failed to use their ionalised monopoly position to drive routes underground across don and to permit easy travel from the north and west of the country through to the South Coast and beyond to the European Continent. Even the advent of the Channel Tunnel as a proposed private sector venture has failed to produce an imaginative response from British Rail who believe that existing facilities can, in the first instance, handle the massive surge in traffic likely after the opening of the cross Channel link.

The result is that Britain has a Victorian railway network alongside a post war motorway network. The motorways have turned out to be much more competitive, taking people to and from the places they wish to visit at a speed that they find on the whole more acceptable than the railway. Whereas the motorway network has been expanded to reach ever more destinations acting as a magnet for freight and passengers, the railways have turned their backs on single wagon marshalling and have allowed a large number of freight sidings to be closed down. Only very large bulk businesses have enough freight to make up whole trainloads. The tentacles of the railway system have gradually been retracted in the face of the alluring competition from roads.

Nor have the railways reflected the shifts in population and travel patterns. Until the British Airports Authority had been privatised and inaugurated a private sector scheme, no proposal existed for a direct rail link from Heathrow to the centre of London. Heathrow is the world's busiest airport, whose growth over the last 30 years has been colossal. Taxis, buses and the underground have all linked in to its huge market potential. British Rail has ignored it. Again, large new settlements have sprung up, seldom well served by railways yet attracting no major railway expansion. For example, the Thames Valley has been a major growth area for the last 20 years, with a huge influx of hi tec industry and associated housing; yet the main route serving it remains the Waterloo to Reading line whose running speeds are slow and whose bottlenecks preclude increasing the number of trains required to handle properly the burgeoning traffic. Lastly, a number of industries, leisure centres, amenity parks and industrial estates recently built around the country could have provided a decent business for British Rail, had its system of wagon marshalling been flexible enough, and had it been prepared to negotiate with the private sector over opening up branch lines and sidings. Very little of this has happened.

The conference was reminded that British Rail is responsible for 11,000 route miles of railway track across the country. It has £2,000 million of assets on its balance sheet. These assets are, indeed, at the centre of the argument about how Britain is going to cope with the growing volumes of freight traffic and the increasing number of passengers' journeys which economic prosperity is bringing in its wake.

The story of 'sector management'

The conference thought it helpful to classify the different activities undertaken by British Rail:

i) The mainstream travel business, running trains over track, carrying passengers and freight.

ii) The large engineering business. Although British Rail Engineering Limited is being privatised, which will return new building and major overhauls to the private sector, a substantial engineering facility remains within British Rail embracing both routine maintenance of locomotives and rolling stock and the track and signalling engineering.

iii) The vast property business. Following the Monopolies and Mergers Commission inquiry and management changes at British Rail the industry has greatly improved its identification of development projects suitable for station sites and other property. But the sense of the conference was that, even if things were now moving in the right direction, much more could still be done. The estate is so large and the potential so enormous that there is a source of income and capital for many years ahead from its successful exploitation.

iv) The retail opportunity. British Rail is involved as one of the owners of a large retail estate. And it is now introducing more attractive retail onto its major station sites. This can be developed much further, encompassing many of the provincial stations as well as the London termini (and, especially in the case of London, extending the range of shopping by more imaginative property development).

v) British Rail's provision of a wide range of services. The industry is beginning to discover a wealth of market opportunities. When passengers arrive by car at a station, car parking, security compounds for safe keeping, garage repair, maintenance services and car valeting could all be offered. Inside the station people can be tempted with a variety of services from hairdressing and secretarial facilities through meals and accommodation to more esoteric specialities.

British Rail has changed to 'sector management', recognising that distinctive businesses exist within the British Rail stable. nter City handles the long distance passenger traffic, Freight andles all goods, Provincial handles the rural line network and ondon and the South East handles the commuter passengers into he metropolis. The division is a little crude. It is not based pon the track itself, as Freight, Inter City and one of the ther sectors all overlap on a particular piece of track. Nor is t entirely based upon the type of travel as there is some clasic commuter travel within the provincial services and there are me semi-rural lossmaking services within London and the South ist. Freight is the most clearly differentiated business, where st and revenue allocations are easier to make than those of ovincial and Inter City. No one, however, during the course of e debate recommended privatising British Rail based upon its n sector businesses.

Is British Rail a monopoly?

The conference considered this issue: important, for it has a bearing upon the style of regulation, the introduction of competition and other issues arising in any privatisation. Richard Hannah put the case forcefully that British Rail was not a monopoly because its share of the market had been falling so rapidly. In 1967 British Rail had 10% of the passenger market and 17% of the freight market. 20 years later this share had fallen by 30% in the case of passengers and by almost 50% in the case of freight to 7% and 9% respectively.

Other speakers argued that although British Rail was under strong competition from road and air transport it nonetheless enjoyed an important and complicated monopoly of certain kinds of travel. There is little choice for the commuter into and out of central London at peak hours, given the huge congestion on the road system. Nor is there much choice for the medium and long distance heavy freight traffic using complete trains to carry aggregates, coal, china clay, rubbish and other bulky items around the country. On the other hand it was generally agreed that competition is substantial for passenger inter city travel and for some off peak rural travel where buses provide a feasible alternative.

The sense of the conference was that, since there were strong elements of monopoly within the system, any privatisation scheme was bound to look at some combination of regulation and competition in order to protect the customer's interest.

4.

Protections to build into privatisation

The Secretary of State made it clear in his address that he would be driven by considerations of safety and better customer service. Within this, the conference identified a number of areas where protection was crucial. First, price. This was an appropriate issue to debate on a day when British Rail announced overall increases of 9% (3.1% above the rate of inflation) and singled out longer distance commuter trains for particularly high increases ranging up to 20%. The captive commuter in particular will demand a measure of stability under a privatised regime so that he can plan his housing and lifestyle on the basis of realistic estimates of travel costs.

The passenger also needs some reassurance that any scheme ould not allow a private operator or operators to take cash out f the business and to reduce service to the point where the ourney, whilst being possible, was of unacceptable quality. here have been times under nationalised ownership when, for a ariety of political and managerial reasons, the standard and uality of service has deteriorated sharply. A railway does need o renew rolling stock, review the length of trains, and keep its leaning and catering standards up to the mark in order to get he respect and goodwill of its passengers. It also needs to andle signalling and engineering well enough to have some chance keeping to timetable; surveys have revealed that punctuality d cleanliness are at the top of passengers' requirements.

Under either a regulated or a competitive model punctuality d cleanliness could both be monitored quite precisely, and gular statistics compiled. In the regulated model the managers d shareholders could be penalised for failure to hit stated andards. In a competitive model other train providers would me forward to improve on standards where the dominant local operator was falling short of the mark.

The paramount consideration in regulation, as the Secretary of State indicated, would be safety. On this most complicated question, the conference went into no detail. The problem is evident, that there is no such thing as absolute safety. It is possible to spend more and more money improving safety, but the point can never be reached where a guarantee can be given that there will be no accidents. With whatever reluctance, decisions have to be made about the level of safety and the margins built into the system.

The general conclusion to the debate on competition and regulation was that some combination of the two could adequately cover the public's demand for a high quality service which was both realistically safe and sensibly priced. By and large both the panel and the floor were optimistic that a new regime would improve on all of these aspects; this indeed must be its aim.

Could British Rail attract the City?

Richard Hannah gave the fullest answer to this question. He was optimistic, believing that the City would make funds available for investment providing first that a system of grants was formalised so that shareholders would know what support railways were going to obtain from the Government; and, second, that the question of employee motivation was addressed.

His belief that an important element in British Rail privatisation should be a substantial employee stake met with considerable sympathy. If (as he favoured) British Rail was sold as a complete entity, about a quarter of the shares could be made available to the employees on very favourable terms some three years before the flotation. He argued that this would greatly improve motivation, and speed the necessary process of improvement and change within the industry. Others, reluctant to see the sale of BR as a unified whole, were nonetheless sympathetic to the proposal for substantial employee shareholdings.

Richard Hannah pointed out that the transport sector likes privatisation issues. The price of Associated British Ports shares has risen 780% since the issue in 1983 and the company's reputation has changed from being union-dominated and go-nowhere to being seen as an exciting, modernised business. The experience of British Airways and, more especially, of the National Freight Consortium has also been favourable.

In Richard Hannah's belief BR's investor appeal would stem from its commercial potential. The business in stock market terms may not be large compared to the mega privatisations of gas, electricity and the complete water industry. British Rail could be a recovery stock, with people anticipating substantial improvements in revenues and operating results if employee co-operation became real, and as British Rail traffic built up in reply to the congestion of the alternative.

The question of employees' morale much engaged the conference. Agreement was general that morale is not high, that the industry is not well paid, that recruitment is difficult. Many thought that employees should be motivated more through a combination of profit sharing and bonuses in pay for better quality service and more business, and through a more streamlined management system creating clearer lines of responsibility and better relationships between managers and men, together with some direct employee share participation as mentioned above. Indeed, one speaker held that staff was the key to the whole debate. All agreed that this was a vital matter for any future privatisation plan. Where employees had been seen as liabilities in the age of BR's decline, they should now be seen as assets, higher morale contributing to a more commercial railway.

6.

Structures for a privatised BR

The Secretary of State's exposition of the different options, printed in the Appendix, is clear and comprehensive.

First, it could be privatised in line with the policy of 'sector management'. As he pointed out, this does not solve the problem of who owns the track; nor can this option be 'pure' given the overlaps between the businesses and track ownership. No one spoke in favour of this option -- the weakest, surely, of them all.

The second option is that of BR plc. This, as the Secretary of State said, provides continuity in management and style of operation, and would minimise the cost of change. The shortcomings are many. First no new competition would be introduced. Second, the business is very diffuse, almost to the point of being unmanageable. The many tiers of administration and the overlap of the different business sectors have led to diseconomies of scale; and, as noted above, the nationalised industry over 40 years has not succeeded in extracting significant benefits out of singular ownership of the whole network. Under the present management system there is no way of distinguishing between those routes which do require subsidy and those which do not; so the subsidy is made available in relation to total losses. And what exactly is the public buying for its cash? It is hard to know. It was notable that no one at the conference spoke in favour of BR plc as a model, even though some of those present had once worked for British Rail. It is said that several BR directors favour this particular option; it would be helpful if its full benefits could be set out so that the case for it does not go by default.

The third option calls into being a track authority. This provides competition in running trains over the track, bringing in new participants to the marketplace. David Starkie and the Adam Smith Institute spoke up strongly in favour of some variation on this theme, although pointing out that they would be happy to amalgamate part of it with the regional company model discussed beneath. The Secretary of State saw three difficulties in this model. First, the track authority itself would be a monopoly creating pricing and quality problems. Second, the track authority would be remote from the customers; responsibility and accountability for shortcomings on this morning or that would be hard to pin down. Third, investment would be hard to attract. Sir Christopher Foster of Lybrand and Cooper was especially damming about this model.

Objections to the pure track authority model are hard to meet. Since even its keenest advocates concede this; and admit that it may be best considered in conjunction with the regional company model, we move on to look at two stronger runners.

One is the restoration of the regional companies, strongly urged upon the gathering by Andrew Gritten, author of 'Reviving the railways: a Victorian future?'. The Secretary of State said that this would greatly improve morale; many railwaymen still hanker after the Great Western or the London Midland in preference to the nationalised concern. Attitudes are deep set even though the regional companies disappeared so long ago. The system of regional companies would offer considerable flexibility; and make the task of managing much easier, removing the national tiers of management and headquarters staff.

There are objections. First, through ticketing would be more difficult (though of course airlines manage, as do British Rail and the Tube). Second, through trains would be loaded with complications, requiring agreement between the different regional companies. Third, each region would have strong elements of monopoly. These difficulties are not insuperable, but as with the track authority they point towards a hybrid.

The last of the five options is to produce a hybrid. Under such a model some parts of the railway would be sold off along lines which reflected the existing divisions, and other parts as integrated regional businesses.

Many permutations are possible. One of the most promising would be the segregation and sale of the freight side as a separate national business running over other companies' track. London and the South East would be an obvious area to keep together, as an integrated railway with its own track and trains, reflecting the compact geographical unit, and the fact that the traction system on Network South East is distinct from that of the other principal rail regions.

With the other regions -- including Western, Midland and the two northern regions, East and West Coast -- there is scope for more experimentation. Each of these contains a regional local network with provincial and commuting services and an Inter City service running over its track and extending well beyond its boundaries. It would be possible to turn Inter City into a separate business like Freight and build on the independent business structure already established by British Rail. This would leave the provincial and commuting services in the hands of a series of regional companies who would enjoy line rental or track lease payments from the Inter City as well as the Freight railways. Alternatively, some elements of the Inter City services could be left with each of the regional companies. The tracks could also be used as a common carrier, with other operators allowed to bid to run trains over them.

To succeed, the regional companies would need to retain some of the property assets. Indeed, one of the most obvious ways to finance the railways in the future is to draw on the great asset strength which lies in property, in order to offset the huge liability of the size of the labour force, and the social obligations of the provincial railway.

7.

Regulation

'he Secretary of State has made clear that the paramount consid-
rations in all regulation would be safety. At present British
ail would argue that safety has a most important bearing on the
tandards of track maintenance, signalling and other engineering
ervices. Any privatised railway system would need to demonstrate
hat existing safety standards were not being compromised; in
ome cases, indeed, being improved.

Regulating for safety would require an independent national
nspectorate, perhaps residing in the Department of Transport or
rhaps set up as an independent body under the Department, which
uld lay down standards and ensure that the railway managers
hered to them. The safety regulations would have to cover the
andard of maintenance of the track and signalling, the frequen-
of inspection, review and renewal. It would also have to
ver drivers' hours, standards of tuition and the like.

As one speaker argued, any new regime will require national
creditation for train drivers undertaken by a body separate
m British Rail and, perhaps, a national college where drivers
train to the accepted national standards. At the moment
tish Rail has a monopoly over training; this would have to be
ken so that other companies had a chance of running train
vices over the deregulated networks.

In summary, the national inspectorate would license both
agement companies and train drivers and crew. There would be
ional standards, policed by the inspectorate, and companies
drivers would have to renew their certification at specified
rvals. The system could be similar to that applied to the
ine industry where there is both frequent inspection of the

standards of maintenance of aeroplanes and a system of pilot licence renewal.

The second task for regulators would be to address the problem of service, quality and frequency. As soon as discussion touches upon changing the present configuration of the railways reactionary forces suggest that it will mean wholesale route closures, especially on the provincial railway. This, of course, would follow the pattern of the last 30 years, in which cost reducing measures have led to substantial reductions in route mileage covered on the provincial network. Although the Beeching proposals were the most notorious, the trickle of service withdrawals since then has been steady.

It is unnecessary to change the existing procedure for closure, if popular confidence was thought to be undermined by modifications. At the moment British Rail has to submit a closure proposal, after which there has to be consultation and a suggestion for an alternative method of carrying out the transport requirement in question. It is a long and cumbersome procedure which slows down British Rail in closing lines, and is therefore generally welcomed.

Tackling subsidies

It may be possible to devise a system for expanding the provision of rail travel and end the long, slow retreat from maintaining provincial services. But the provincial network is going to require subsidy. The volume of passenger demand simply is not great enough, especially in the lowly populated regions including Wales, the South West and Scotland. If the railway is split into a series of regional companies it could at the same time be set up in such a way that other companies could tender to run services across a regional company's track. If this element of competitive bidding were introduced it may well be that new methods could be developed of reducing costs and of attracting more customers to narrow the gap between fare revenue and expenditures.

In order to ensure that this took place on a fair basis a nationally agreed policy would have to be devised for subsidy distribution and tendering. The regulator, having adjudicated on safety, would also have to adjudicate upon the claims of different companies and people to run trains over each regional company's track. He or the Department of Transport could do so most effectively by offering subsidy for bids for parcels or packages of services that people would be happy to run for a given price.

It may well be that if the subsidy were put out to tender more route miles could be travelled in a way which better reflected the modern pattern of demand. One of the criticisms of the railways during the last 40 years has been their defensive attitude: based upon trying to protect routes and services which reflect patterns of demand that no longer exist. The difficulties of closing down old routes and services has led to a reluctance to set up new ones. Local communities could be consulted and the subsidy regulator could determine a minimum basis of service that a company had to provide whatever the subsidy cost. Flexibility would be necessary in distributing the balance of the subsidy to maximise the number of route miles run.

What is important is that in any such distribution the system should switch from being a global subsidy paid to the rail operator to cover losses to being a specific subsidy, probably based on pence per passenger mile travelled, to ensure that particular routes and services were operated at the least cost. To do this the Government needs to define more closely what it is trying to buy with its subsidy; and the rail system needs to introduce a competitive element into the tendering for subsidy to ensure that the best business solution is achieved.

The final area of concern to the regulator should be the quality of service in relation to fares. Under a nationalised monopoly fares have risen sharply in real terms over the years, despite the payment of large subsidies for revenue losses and the write-off of substantial amounts of BR's capital. The total subsidy paid to the rail industry has spiralled upwards in the last twenty years. Only recently has there been some reversal of this and at the same time some success in wooing new passengers onto the railway network in many parts of the country. These two factors are related.

Quality of services is still seen as poor, even although management is now much more exercised about improving punctuality and cleanliness -- the two most important elements in the public's appraisal. The announcement of a massive (£3.8 billion) investment programme over five years should also ensure that much needed new rolling stock is introduced, which should enhance the image of the railways in the eyes of the travelling public.

Wherever monopoly elements remain in a privatised railway system there will need to be some form of price control. A pledge to keep prices rising at no more than the general rate of inflation would bring about a very much better state of affairs than we see now. The regulator could also set basic standards of quality, like a requirement for both punctuality and cleanliness to be ascertained by objective criteria.

some of the surplus land being shed for alternative uses and retail and office property constructed over or adjacent to the stations. Almost everywhere in the British Rail portfolio derelict and surplus land is still to be found which could reap important development profits.

Much heavy weather is made of valuing British Rail. In a sense it does not matter what the business is worth, as long as any privatisation scheme improves the service for the passenger and ensures that BR's national assets are well used for transport purposes. The Government can make the assets worth almost as much or as little as it pleases. Writing off debt, guaranteeing substantial subsidy or being flexible over the route patterns to be followed would all help to maximise the cash proceeds of the sale. On the other hand, minimising the amount of subsidy that vas to be pledged to the railways in the future, refusing to vrite off debt, and being very strict over maintenance of existng routes would be a way of lowering the value of the railway to ractically nil. The true political choices must relate to the ype of railway we wish to see in this country, and the ways in hich the railway can be improved for its passengers. In such a ebate an exact valuation of the assets does not matter. All hat does matter is that once the structure has been established nd the other policy decisions taken, the sale of the assets hould then be effected with the proper degree of competition, so hat on the day the right price for them is obtained.

Doubtless after privatisation the new owners will be accused making use of the properties in order to get fat profits. But veryone should be well aware prior to privatisation that propery improvement is one of the most attractive business opportunies within the railway and will become one of the main ways of upplementing revenues from fares to finance the other necessary ransport activities.

Conclusion

All who were present at the CPS railway conference agreed that the railways should now aim to:-

i) become a growth business;

ii) draw more fully on their property assets to help finance that growth;

iii) speed innovation in the network, and develop new routes and services which reflected changing passenger demands and shifting populations;

iv) develop a method of allocating subsidy specific to routes which the communities wished to maintain, based on pence per mile travelled to encourage management of rural services to save costs and maximise revenue; and

v) establish a national inspectorate for safety and quality, along with a national training centre for rail staff, independent of BR.

Everyone recognised the political sensitivity of the provincial network, and the need to develop a subsidy regime which in the future could guarantee basic services in the country without on the one hand continuing to fossilise the routes as at present or on the other offering a blank cheque (filled out for ever growing sums) to those running them. The suggestions in this paper may go some way to resolving these difficulties. Everyone seeks a successful, growing railway capable of responding to rapidly growing passenger demand. To do so there may need to be regional companies, operating companies and much bolder exploitation of the main resources of the railway system.

It will be seen from the Appendix how far this paper reflects the principles outlined by the Right Honourable Paul Channon, MP, Secretary of State for Transport. It draws on Richard Hannah's encouraging work in evaluating the business, which led the audience to believe that the railway industry could be an exciting growth industry given the right management and operating regime. It does, however, question his suggestion that BR plc should be kept as an integrated whole. It draws on David Starkie's idea of a separate track authority with others running trains over it, insofar as the regional companies outlined would be subject to competitive challenge on some of their routes and other companies could run trains over their network. It also draws on Andrew Gritten's work favouring regional companies, especially in the case of Network South East which it is recommended should remain as an integrated network company. Finally, it draws on Tony Ridley's optimism about the future for London Underground and his belief that congestion above ground coupled with sensible capital expenditure underground signals the way ahead. Similar truths apply to British Rail.

If one word can sum up a conference, that word would be 'opportunity'. Opportunities abound in this congested island for a railway renaissance. In order to provide yet more transport competition maybe the CPS' next pamphlet or conference should be about a waterways' revival!

APPENDICES

Speech to the conference

by

The Rt Hon Paul Channon MP

Secretary of State for Transport

I WANT TO EMPHASISE AT THE START THAT HER MAJESTY'S GOVERNMENT has not decided to privatise British Rail. There is no chance of doing so in the lifetime of this Parliament. What we have decided to do is to look at the long term options for BR so that we can plan a successful future for it in the 1990s.

Of course we must look at privatisation as an option. But it will only be an option that is chosen if we are convinced that we can provide better service to travellers in some privatised BR than has been done up to now.

So I welcome the look at all the options. I welcome the CPS conference. I welcome the pamphlets by Andrew Gritten and Kenneth Irvine. Let us go on analysing the best way forward for BR.

To do that we must obviously consider possible ways of privatising it so that if we do decide to do so we can see the advantages and disadvantages of each course.

Before I come to that I want to emphasise to you how well BR has done in recent years.

Progress by BR

First, BR is far less dependent than it was on financial help from the Government; and by the same token depends much more on what it can earn from its customers. In 1983, BR received a central government grant worth in today's prices £1050 million. This year the figure will be under £600 million, a reduction of more than 40%. But this is by no means the end. Further substantial reductions are planned, and will require continuing management effort and drive.

The major part of the railway is now required to operate without government subsidy. Freight and parcels have for some time been required to work to a financial profit target, and grant was withdrawn from the Inter-City sector this year. So these sectors now constitute a large commercial railway. The Board's Corporate Plan aims to have Inter-City and freight earning a 6% current cost return on assets within the next 5 years. So there is still more work to do there.

These changes have not been secured by cutting investment in the railways. On the contrary, the board's capital expenditure is at record levels, with £3.8 billion planned to be spent over the next 5 years. Major new projects are going ahead, such as the electrification of the East Coast Main Line and the new train services for the Channel Tunnel. At the same time, big programmes of renewal of existing services are in progress.

Third, the railway is winning more traffic. The figure of passenger traffic last year was the highest for 27 years. The Network SouthEast commuters trains and the Inter-City trains have both been carrying increasing loads. So demand is very strong.

These changes have been helped forward by the clear framework of policy we have set for BR. We have given them published objectives on both financial targets and quality standards. Major changes have been achieved. BR management rightly show a new-found sense of confidence and enterprise. We have backed their progress by approving major investments. Our policies have brought British Rail to the point where it is right to think about the long-term options.

On the question of quality of service the position is mixed. Many Inter-City trains are of a very high standard. Further improvements like the electrification of the East Coast Main Line are in hand. Many new trains are being provided on London commuter services. But further improvements are possible. What about Inter-City trains with a guaranteed meal service? Seat reservations for commuters? Off-peak season tickets? Privatisation should provide a stimulus for fresh thinking on how the customers' real needs can be met. And there are areas like commuter services where the quality of service needs real improvement. Investment last year in Network SouthEast totalled £165 million, an increase of 65% on the previous year, and BR and I are determined to achieve considerable improvements.

The Governments's position

I do not need to spell out to this audience that we prefer to see commercial businesses run in the private sector and subject to commercial disciplines. That makes them less dependent on government decisions. It puts the business on the same footing as their competitors. It means above all that they have to pay attention to the needs of the customer if they are to win business and develop.

In looking at BR we have to test how these considerations apply in this specific case and ask ourselves whether there are any special ones. I believe that there are indeed 3 special points that we have to put our minds to from the start.

First, there is safety, which requires rigorous oversight by an independent inspectorate. For nearly 150 years, the Railways Inspectorate has had oversight of railway safety, and railways are in fact an extremely safe form of travel. We must ensure that the highest standards of safety are maintained. That is paramount.

The second is that some of BR's operations, though not the majority, receive substantial subsidies. There are the main London commuter services - though here the subsidy level is rapidly coming down - and the large provincial network which is maintained for broad social reasons. Much local importance is attached to it.

Now we have to be clear that subsidy does not depend on ownership. We would anyway have to look closely at the reasons for subsidy, as we have already been doing, and see whether the mechanisms for deciding and paying subsidy can be improved. As I say, these are issues irrespective of ownership. The question of ownership certainly does not raise a new issue of principle, though it may present questions of mechanics. I think it is sufficient for me to point out that we have throughout our nine years in office maintained a large subsidy to the rural network and that has not been called in question.

The third special point is that in some markets the railway is dominant. In most cases it faces strong competition, but in carrying commuter traffic into central London from outside the London area, the railway has a dominant share. So in that case there are important questions of consumer protection.

Under the present regime these are handled as part of ownership. I set financial targets to the Railways Board, and I have established with them quality standards for the commuter services. But as a Government we do not believe that the best protection of the consumer is secured by keeping the industry in public ownership. That is not our position. Private ownership may be a way to offer the consumer greater diversity of choice. Our preference is to deal specifically with the need for regulation, and where there is market dominance, to protect the interests of the traveller in that way. That ought to be better for the consumer. The exact arrangements that would be suitable need to be worked out according to the character and structure of the industry.

I shall return to these questions of subsidy and regulation after I have described some of the options that occur to me.

How then might BR be privatised ? In no particular order the possibilities are:

- a division of the railways into a number of independent regional companies;

- a vertically separated railway industry with track owned by a track authority or company and independent operating companies which would run the trains, generally known as the "track authority" option;

- a single company to run Britain's railway network, what has been called in the press "BR plc"; and

- a division into several independent companies based on British Rail's business sectors. I will call this the "sector" option.

Finally there is no need to stick to a single option for the whole railway. It would be perfectly possible to combine aspects of more than one of the other options. For example a division into independent companies based partly on regions and partly on sectors might be possible, or an arrangement where parts of the railway were run by independent vertically integrated companies and other parts had a track authority and operating companies.'

If any one can think of any other options which ought to be seriously considered I would be glad to hear from them. We have not ruled out any options.

There has, of course, been extensive press coverage of some of them. And papers like Andrew Gritten's have helped focus the debate. We now need to consider how well each approach would help us overcome the problems I have identified of dependence on subsidy and monopoly position. We also want to consider which option would maximise the benefits of better service to customers and new opportunities for investment to provide this, freedom from public sector constraints, the chance of competition and adaptation to market needs and benefits from new technology world-wide.

All of the privatisation options should in principle improve the railway's responsiveness to their customers. If your profits depend on generating more business you have a very strong incentive to offer the customer the best possible service. But which option is most likely in practice to sharpen that incentive ?

The options considered: regional railways

Let us look first at regional railways. Attractive though it is to look back nostalgically to the railways of the past, our approach to regional companies has to be forward looking. Would they meet the needs of the late 20th and the 21st centuries ? Regional companies could have a number of advantages. They would allow some competition to be introduced, though this might be largely indirect. Morale might be improved by building on local loyalty. It might be possible to achieve more flexibility on a local basis than in a national organisation and in some companies (though certainly not all) the management task could be made simpler.

What about the problems ? Through ticketing is often quoted though it would seem probable that independent companies would have a strong commercial incentive to make adequate arrangements for through travel. This has certainly happened on the airlines, and on a world-wide scale. Through trains would be a larger problem, particularly freight trains which often take little account of regional boundaries. It is possible that economies of scale would be lost though it is open to debate whether railways need to be as large as BR to achieve them.

More significant could be the mix of businesses within each region. Several of the current BR regions have almost as great a range of types of business as BR as a whole, with all the problems of dividing management attention this implies. Moreover, the loss-making provincial services would be spread fairly evenly around all the regions with the exception of Southern and Anglia. Several of the railways based on the current regions would inevitably be dependent on subsidy to a significant extent.

Track authority

Let me turn to the track authority option. The main advantage usually quoted is the opportunity for the introduction of competition in the actual running of trains, with a number of independent companies using the same track. The welcome we have given to the possibility of a private rail link to the Channel Tunnel shows we are open-minded on that.

But competition between railway companies will be limited by the practicalities of railway operation and the main competition from many rail services would be from car, coach or air. The track authority itself would of course be in an entrenched monopoly position in relation to the operators, and moreover would be more rather than less remote from the eventual customers. It is clear that the monopoly position of the track authority could

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Unitary BR

A unitary BR has obvious advantages of continuity and minimising the cost of change. It would not require new arrangements for through ticketing or inter-company transactions, though better allocation of costs and revenues within BR will be desirable. There could be no question of losing any possible economies of scale.

On the other side, the opportunity to introduce even limited competition would be missed. Direct competition might be limited but even indirect "competition by emulation" could provide useful information to those responsible for regulation and subsidy. It is possible that railways do not need to be as large as BR to achieve economies of scale, while the very size and spread of BR's activities may introduce what might be called "diseconomies of complexity". A unitary BR would clearly do nothing to help emphasise the distinction between services requiring subsidy and those which did not. The balance of pros and cons clearly needs a great deal of thought.

Business sector railways

Railways based on BR's business sectors would avoid some of the problems of complex objectives and dilution of commercial incentives, since the loss-making services would be concentrated in the Provincial Sector. However the option runs up against the serious problem of who would own the track. Much of BR's track is used by more than one sector with Inter-City and Freight in particular sharing much of their networks. Someone would need to own the track; if this was the sectors themselves on a geographical basis you would have something akin to a regional option; if an umbrella body then this is probably a form of the BR plc option. And if a third party it is a sort of track authority option.

Hybrid options

Finally one might consider hybrid options, for example combining some of the features of the sector and regional approaches by basing a division partly on geography and partly on business sector. It is possible that some such option would allow some of the better features of the others to be incorporated, while avoiding some of the drawbacks.

Subsidy

Before concluding I would like to return to two issues to which I attach great importance: subsidy and regulation. First subsidy; there is no reason why privatisation should affect subsidy to services where it is clearly needed. Subsidy does not depend on ownership so privatisation does not mean wholesale closures. Anyone who says it does is simply scaremongering.

The structure of a privatised industry will of course have implications for the precise from of subsidy and the way in which it is paid. It will be essential to prevent subsidy leaking from loss-making to commercial services so it is clear what subsidy is buying. Some options could make this easier by emphasising the distinction between services requiring subsidy and those able to operate without it.

If we are to achieve value for money for taxpayers and travellers alike we must keep up the pressure to reduce subsidy. This is as important for BR in its present form as for a privatised industry. But some rail services will inevitably need to be subsidised for the foreseeable future. Devising suitable arrangements for this will be an essential part of any privatisation proposal. We shall also explore the scope for the private sector to reduce subsidy by offering more attractive services, by new approaches to marketing and by efficiency improvements.

Regulation

Next, regulation. Before the opponents of privatisation start raising hares let me repeat that safety must be paramount. The railways are an extremely safe form of transport and we shall ensure that they continue to remain so, through strong independent regulation.

Regulation will also be needed in some circumstances to ensure that the traveller receives a fair deal. We must ensure that where monopoly power exists, fares and service quality are regulated so that the traveller receives value for money. This will be important for the London commuter services where the railways are in a dominant market position, at least at peak times.

There are a number of obvious questions to consider. What safeguards are necessary on fares and service quality to ensure that this dominant position is not abused? How can we provide the necessary protection while leaving the railway freedom to respond to market demands, for example introducing better services at premium fares if that is what the customer wants? Do we need an obligation to provide services in some circumstances? These regulatory requirements will need careful study to ensure that the benefits of privatisation can be achieved while protecting the interests of the customer.

Conclusion

To sum up, the Centre for Policy Studies and others have blazed the trail in defining options for BR. The possibilities are becoming clearer. More work is still needed on many questions about each option. Does it meet the subsidy problem? Does it take account of the virtual monopoly which BR enjoys in some areas?

All these questions must be resolved in a way that frees a privatised railway industry from unnecessary public control and enables it to provide a better service to the customer by identifying new market opportunities within a changing transport market, operating more efficiently, and investing in modern and attractive services. That will be the ultimate test against which any proposals for privatisation must be judged.

I said in my speech to the Conservative Party Conference that privatisation of British Rail could not be in the lifetime of the present Parliament. In the meantime it is vital that BR keep up the good work and continue to improve efficiency and seek out commercial opportunities. Privatisation may provide a way to take this process further, bringing benefits to customers, the railway workforce and the country as a whole. But whether privatisation goes ahead or not, BR and its management and staff are doing a good job. I know Bob Reid and his colleagues recognise that it is crucial that they keep their eyes on the ball.

I hope it will now be possible to engage in an informed debate on the case for privatising BR and on the means by which this might be done. We have not ruled out any options or made any decisions at this stage. And we are open to new ideas. I am sure today's conference will encourage such a debate. I shall study with care the remarks of other speakers.

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John Petty	Daily Telegraph
Molly Price-Owen	BBC Radio 4
John Redwood MP	House of Commons
John Rhodes	W Yorks Passenger Transport
Dr Tony Ridley	Chairman, London Underground
Derek Ridyard	Consultant, N E R A
Michael Roberts	Lazard Brothers
R D C Smith	Sales Director, GEC Transportation
John Spiers	John Spiers Publishing
John Stansby	Bougues (UK)
David Starkie	Director, T M Economics
T Suga	Representative, E.Japan Rail Co.
K W Swallow	Director General, Merseytravel
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